

IN THE UNITED STATES DISTRICT COURT  
MIDDLE DISTRICT OF TENNESSEE  
AT NASHVILLE

SENTINEL TRUST COMPANY, )  
DANNY N. BATES, CLIFTON T. BATES, )  
HOWARD H. COCHRAN, BRADLEY S. )  
LANCASTER, and GARY L. O'BRIEN, )

Plaintiffs, )

v. )

USDC No. 3:04-0836

KEVIN P. LAVENDER, Commissioner )  
of the Tennessee Department of Financial )  
Institutions, )

Defendant. )

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**DEFENDANT'S SUPPLEMENTAL MEMORANDUM OF LAW IN  
SUPPORT OF MOTION TO DISMISS AND IN OPPOSITION TO  
PLAINTIFFS' REQUEST FOR INJUNCTIVE RELIEF**

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Defendant, Kevin P. Lavender, Commissioner of the Tennessee Department of Financial Institutions, submits this supplemental memorandum of law in support of his motion to dismiss and in opposition to Plaintiffs' request for injunctive relief.

**ARGUMENT**

In addition to the grounds set forth in the Commissioner's original memorandum of law, this Court should abstain from exercising its jurisdiction over this proceeding for declaratory and injunctive relief and should dismiss plaintiffs' complaint pursuant to the *Younger* abstention doctrine. Any such injunctive or declaratory relief granted by this Court would come at the cost

of increasing the friction between federal and state courts and would improperly encroach upon the state's sovereignty and jurisdiction of state courts.

In *Younger v. Harris*, the Supreme Court directed that federal courts should abstain from deciding a matter that would be properly before them but for the pendency of state criminal proceedings in the matter.<sup>1</sup> It subsequently extended this principle to state civil regulatory and enforcement actions.<sup>2</sup> *Younger* abstention also applies in federal declaratory judgment actions because they involve "precisely the same interference with and disruption of state proceedings" as an injunction.<sup>3</sup>

*Younger* abstention is built upon common sense in the administration of a dual state-federal system of justice, particularly in this litigious era where multiple lawsuits arise from the same occurrence.<sup>4</sup> It is derived from two long-standing and important principles. First is that "equity jurisdiction" prevents federal courts from interfering with ongoing state proceedings "when the moving party has an adequate remedy at law."<sup>5</sup> The second principle is what Justice Black called the "more vital consideration" of "comity":

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<sup>1</sup>401 U.S. 37, 43-45, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971). See also *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1, 107 S.Ct. 1519, 95 L.Ed.2d 1 (1987).

<sup>2</sup>See *Trainor v. Hernandez*, 431 U.S. 434, 444, 97 S.Ct. 1911, 1918, 52 L.Ed.2d 486 (1977)(state civil fraud proceeding to recover improper benefits by state welfare department); *Huffman v. Pursue, Ltd.*, 420 U.S. 592, 604, 95 S.Ct. 1200, 1208, 43 L.Ed.2d 482 (1975)(state civil nuisance action against adult theater by local sheriff and prosecutor) and *Middlesex County Ethics Committee v. Garden State Bar Association*, 457 U.S. 423, 102 S.Ct. 2515, 73 L.Ed.2d 116 (1982)(administrative lawyer disciplinary proceeding brought by a state ethics committee). See also *Worldwide Church of God, Inc. v. State of California*, 623 F.2d 613 (1980)(state receivership action of charitable trust brought by state attorney general).

<sup>3</sup>*Samuels v. Mackell*, 401 U.S. 66, 72, 91 S.Ct. 764, 767, 27 L.Ed.2d 688 (1971).

<sup>4</sup>See *Carroll v. City of Mount Clemens*, 139 F.3d 1072, 1074 (6th Cir. 1998).

<sup>5</sup>*Carroll*, 139 F.3d at 1075 (citing *Younger*, 401 U.S. at 43-44, 91 S.Ct. at 750).

[T]he more vital consideration behind the *Younger* doctrine of nonintervention lay not in the fact that the state criminal process was involved but rather in the notion of comity, that is, a proper respect for state functions, a recognition of the fact that the entire country is made up of a Union of separate state governments, and a continuance of the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways.<sup>6</sup>

Abstention in favor of state court proceedings is proper where there exists: (1) an ongoing state proceeding; (2) an important state interest; and (3) an adequate opportunity in the state judicial proceeding to raise constitutional challenges.<sup>7</sup> In determining whether state court proceedings involving the plaintiffs are pending, the Sixth Circuit has held that a state proceeding remains pending until a litigant has exhausted his state appellate remedies.<sup>8</sup>

#### Ongoing State Proceeding

Plaintiffs' complaint for injunctive and declaratory relief under 42 U.S.C. § 1983 presents a textbook case for *Younger* abstention. It is undisputed that there is an ongoing state proceeding. As set forth in the Commissioner's original memorandum, Plaintiffs filed a petition for writ of certiorari and for writ of supersedeas<sup>9</sup> with the Davidson County Chancery Court on

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<sup>6</sup>*Judice v. Vail*, 430 327, 334, 97 S.Ct. 1211, 51 L.Ed.2d 376 (1977)(internal citations omitted). See also *Kelm v. Hyatt*, 44 F.3d 415, 419 (6th Cir. 1995).

<sup>7</sup>*Tindall v. Wayne County Friend of the Court*, 269 F.3d 533, 538 (6th Cir. 2001); see also *Cooper v. Parrish*, 203 F.3d 937, 954 (6th Cir. 2000); *Fieger v. Thomas*, 74 F.3d 740, 744 (6th Cir. 1996).

<sup>8</sup>*Loch v. Watkins*, 337 F.3d 574, 578 (6th Cir. 2003)(citing *Huffman v. Pursue, Ltd.*, 420 U.S. at 609; *Foster v. Kassulke*, 898 F.2d 1144, 1146 (6th Cir. 1990)).

<sup>9</sup>A writ of supersedeas is similar in function to a temporary injunction or stay in that it stays enforcement of an administrative order or judgement pending judicial review of that order or judgment. Tenn. Code Ann. § 27-9-106, which governs the issuance of a supersedeas, provides that:

(a) If the order or judgment rendered by such board or commission made the basis of the petition for certiorari shall make any material change in the status of any matter determined therein, the petitioner may, upon

June 29, 2004, seeking judicial review of the Commissioner's decision to take possession of and to liquidate Sentinel Trust Company. The petition's challenge rested primarily upon the legal argument that the Commissioner had no authority to exercise any of his "bank regulatory powers" against Sentinel, a non-banking trust company, including Tenn. Code Ann. § 45-2-1502, which authorizes the Commissioner to take possession of a state bank in certain circumstances.<sup>10</sup>

The state court held a hearing on the petition for writ of supersedeas and subsequently denied the petition in a memorandum and order issued August 9, 2004. As noted in the Commissioner's original memorandum, the state court had offered the parties the opportunity to have a hearing on both the writ of certiorari and supersedeas, in which plaintiffs could raise their statutory argument concerning the Commissioner's legal authority, as well as challenge the factual foundations underlying the Commissioner's decisions to take possession and liquidate. The Commissioner was agreeable to this proposal and was even willing to stay the ongoing liquidation until such hearing could be held. Plaintiffs, however, insisted that the court proceed with a hearing only on the writ of supersedeas.

Since the state court's denial of the writ of supersedeas, plaintiffs have made no further attempt in the state court proceeding to pursue their petition for writ of certiorari challenging the

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reasonable notice to the board or commission and other material defendants, apply to the chancellor, at the time of filing such petition, for a supersedeas, and the chancellor, in the chancellor's discretion, may grant a *writ of supersedeas to stay the putting into effect of such order or judgment or any part thereof*.

(b) No such supersedeas shall be granted until a good and sufficient bond, in an amount to be fixed and approved by the chancellor, shall have been given by the petitioner, conditioned to indemnify the defendants named in the petition from any injury that may result by reason of the granting of such supersedeas. (Emphasis added).

<sup>10</sup>Petition at ¶ 9.

factual foundations of the Commissioner's decision. Instead, they first sought to have the state court vacate its order denying the writ of supersedeas, asserting that the court had disregarded the law of statutory construction and "merely adopted the Attorney-General's desired conclusion, . . . which — presumably subconsciously — favored the position of the Commissioner and the Attorney-General instead of impartially seeking guidance from the controlling body of law."<sup>11</sup> In the alternative, plaintiffs sought interlocutory appellate review. While the state court denied plaintiffs' motion to modify its order, it did grant plaintiffs permission to seek interlocutory appellate review pursuant to Tenn.R.App.P. 9.

The Tennessee Court of Appeals, however, denied both plaintiffs' application for appellate review under Rule 9, as well as plaintiff's application for extraordinary appellate review pursuant to Tenn.R.App.P. 10. Then, instead of returning to state court to pursue a hearing on their writ of certiorari, plaintiffs filed this lawsuit on September 16, 2004. By that time, the Commissioner had been in possession of Sentinel for approximately four months and the liquidation had been ongoing for three months. Indeed, the liquidation process had progressed to the point that the Receiver had already sent out bid packages to secure replacement fiduciaries for the non-defaulted bond issues and the resulting bids were due September 22nd.

Moreover, in this lawsuit, plaintiffs did not actively pursue a hearing on the request for injunctive relief after the Receiver filed a motion with the Lewis County Chancery Court<sup>12</sup> seeking the court's approval to transfer Sentinel's fiduciary positions on all non-defaulted bond

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<sup>11</sup>See Petitioners' Motion for Rehearing and Modification of the Court's Order of August 9, 2004, For other relief and for Expedited Hearing on such Motion, at p. 3 (copy attached).

<sup>12</sup>Tenn. Code Ann. § 45-2-1502 places venue and jurisdiction over the *in rem* receivership proceeding in the county where the receivership entity is located — in this case — Lewis County.

issues to new fiduciaries. Plaintiffs were given the opportunity to raise their objections to these transfer and now, after having had those objections rejected by the Lewis County Chancery Court, plaintiffs have amended their complaint seeking to enjoin the proceeding in that court as well. Thus, the first prong of *Younger* abstention — an ongoing state proceeding — is clearly met.

### **Important State Interest**

Unquestionably, the State of Tennessee has a strong interest in the operation of all financial institutions within the state. Indeed, the United States Supreme Court has recognized the importance of banking and financial services as matter of state interest.<sup>13</sup> The State's interest is particularly strong where a financial institution is acting as a fiduciary — such as a trust company — as it is entrusted with millions of dollars on behalf of other entities. For example, at the time the Commissioner took possession of Sentinel, it was holding approximately \$36 million in fiduciary investment assets on behalf of numerous municipalities and private entities.

Furthermore, in order to ensure the safe and sound operation of financial institutions engaged in fiduciary activities, the State must be able to investigate and determine the financial viability of those institutions, so that there is a reasonable assurance that the fiduciary funds are used solely for the purposes intended as forth in any Indenture or Trust agreements. To that extent, the State has enacted a complex statutory scheme for the regulation of financial institutions that, among other things, allows the Commissioner to take possession of and liquidate, if necessary, a financially troubled bank or trust company. Thus, the Commissioner's

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<sup>13</sup>See *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 44, 100 S.Ct. 2009, 2019-20, 64 L.Ed.2d 702 (1980). See also *Old Sione Bank v. Michaelson*, 439 F.Supp. 252, 255 (D.R.I. 1977).

imposition of a receivership on Sentinel Trust Company is an integral element of the State's enforcement of that regulatory scheme. Enjoining enforcement of the ongoing liquidation, including the most recent orders of the Lewis County Chancery Court approving transfer of the non-defaulted bond issues to substitute fiduciaries, would most certainly violate the principles of federalism, equity and comity that *Younger* abstention seeks to preserve.<sup>14</sup> As such, the second prong of *Younger* abstention exists here, and plaintiffs should be required to first exhaust their state remedies in challenging the receivership before seeking relief from this Court.

**Adequate Opportunity in State Proceeding to Raise Constitutional Challenges**

The final prong of *Younger* abstention requires that the ongoing state proceeding provide an adequate opportunity for the plaintiff to raise constitutional challenges. Here, plaintiffs do not contend that they cannot assert their constitutional challenges in the ongoing proceeding in Davidson County Chancery Court.<sup>15</sup> Rather, plaintiffs' only complaint concerning this proceeding is that the state trial court ruled against them on their legal argument that the Commissioner acted without statutory authority — the very same argument that is the basis of their request for injunctive relief from this court.

The Sixth Circuit has held that when a person is the target of an ongoing state action involving important state interests, that person cannot interfere with the pending state action by maintaining a parallel federal action involving claims that could have been raised in the state case. If the person files such a case, *Younger* abstention requires the federal court to defer to the

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<sup>14</sup>See *Worldwide Church of God, Inc. v. State of California*, 623 F.2d at 615.

<sup>15</sup>In fact, plaintiffs raised several constitutional challenges in their petition for writ of supersedeas that were argued before the state trial court and subsequently ruled upon by that court in its August 9, 2004 memorandum and opinion.

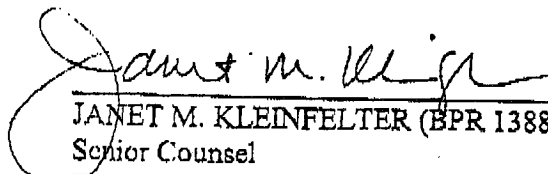
state proceeding.<sup>16</sup> Here, plaintiffs not only have attempted to interfere with the ongoing state court proceedings by filing this lawsuit seeking federal injunctive relief, but have done so on the basis of the very same claim that was raised and ruled upon in the state court proceeding.

### CONCLUSION

Accordingly, *Younger* abstention in this case is entirely appropriate as it would prevent further interference with the state court proceedings in the Davidson and Lewis County courts, would avoid duplication of legal proceedings, deferring to the State's sovereignty over its laws, and would respect the principles of comity inherent in our federalism. Given these considerations, the Commissioner respectfully requests that this Court abstain from exercising its jurisdiction and dismiss Plaintiffs complaint in its entirety.

Respectfully submitted,

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<sup>16</sup>See *Carroll v. City of Mount Clemens*, 139 F.3d at 1074-75 (citing *Watts v. Burkhardt*, 854 F.2d 839, 844-48 (6th Cir. 1988); *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1, 15, 107 S.Ct. 1519, 1528, 95 L.Ed.2d 1 (1987) ("when a litigant has not attempted to present his federal claims in related state-court proceedings, a federal court should assume that state procedures will afford an adequate remedy.").